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A BRIEF SUMMARY OF THE FARM CREDIT SITUATION AND ADOPTED AND PROPOSED SOLUTIONS

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THE FARM CREDIT SITUATION

FACTORS CAUSING THE FARM CREDIT PROBLEM

There is mistaken belief that, for the farm sector, the farm credit problem is caused by a decline in farm income. Net cash farm income, which is a measure of immediate financial stress, averaged $36.3 billion from 1978-1980 and $38.8 billion from 1983-85, a 7% increase. In addition, interest expense (excluding farm households) increased from $12.5 billion in 1979 to $20.2 billion in 1984, a 62% increase. These figures suggest that if interest expense had not increased, net cash farm income would be $10.2 billion greater than in 1979. This in turn suggests that farmers who have little or no interest expense are better off as a group than in 1979.

The question becomes what caused the increase in interest expense. Interest rates are usually cited. But this alone is not the cause. According to USDA figures, average interest on outstanding farm debt, including farm households, increased from 8.5% in 1979 to 9.9% in 1984. Total farm debt (including farm households) averaged $153.5 billion during 1979 and $214.4 billion during 1984. Applying 1979 interest rate to 1984 debt yields interest expense of $18.2 billion, which is only $2.9 billion less than the $21.1 billion in interest expense for 1984 (including farm households) but $5.1 billion more than 1979 interest expense of $13.1 billion (including farm households).

The conclusion is that a major cause of the farm credit problem was the tremendous serge in farm debt between 1979 and 1984 (actually 1982 since it has declined slightly since). Individual farmers were hurt by increasing interest rates and declining farm income, but the farm sector numbers suggest that farm debt is a far more important variable.

The policy implication is that, to deal with the farm credit problem and to insure survival of a farm, an interest rate buy-down program will go only part of the way. Farm debt must also be reduced.

SOLUTIONS IN PLACE

INTEREST RATE BUY-DOWN

The farm bill contains an up to three year interest rate buy-down program for FmHA guaranteed loans. Funded at $490 million over 3 years. The Secretary will fund up to 50%, but not more than 2 percentage points, of any buy-down agreed to by the commercial lender of the guaranteed loans.

CONSERVATION EASEMENT

Under this provision of the Farm Bill, the Secretary may obtain a conservation easement for a period of not less than 50 years on land secured by an FmHA loan. In return for the easement, the Secretary shall cancel a proportional amount of the outstanding loan.

FARM CREDIT SYSTEM RELIEF BILL

The ultimate purpose of this bill was to reassure the bond markets about the long term survivability of the Farm Credit System. The bill has evidently been successful since the basis differential between farm credit system bonds and treasury bills has narrowed from as much as 100 basis points to around 40-60 basis points. This decline in the basis has helped farmers who borrow from Farm Credit System.

FARM BILL

One goal of the Farm Bill was to freeze target prices for two years, with a slow decline for the next two. By maintaining farm income some marginal farmers can keep their cash flow up to the point where they can survive. The problem is that the Farm Bill does not target its income assistance to those in financial stress. Therefore, most of its income maintenance benefit goes to farmers who would probably survive anyway. Of course, any decline in farm income caused by Gramm-Rudman-Hollings will increase financial stress and the number of bankruptcies.

PROPOSED SOLUTIONS

COMMERCIAL INTEREST RATE BUY-DOWN

Senator Boschwitz has proposed a federal, state, and lender buy-down of interest rates. His proposal called for each to contribute 2, 2, and 1 percentage point buy-down. This proposal has the potential, if targeted correctly, to help farmers who could survive with increased cash flow from interest rate reductions alone, but it would do little for most farmers under financial stress since their debt loads are too great.

LOAN LOSS AMORTIZATION

Senators Dixon and Zorinsky have proposed allowing commercial banks to amortize their loan losses over a 10-30 year period instead of taking the loss in only one year. This would increase the survivability of the bank by reducing the drain on capital reserves. It would probably also lead to lower interest rates because the bank would not have to increase interest rates to offset their loan losses. Senator Garn agreed to hold hearings on this proposal during early 1986.

FEDERAL LAND BANK RESERVE

It has been proposed that the federal government take over land which is or shortly will be foreclosed. The purpose is to keep the land off the market for a limited period of time (up to 10 years), thereby proping up land prices. This proposal appeals to lenders because by proping up land prices the potential for loan losses is reduced, i.e. they can sell the foreclosed asset for a higher value. This proposal does little for farmers under stress because it is the burden of their debt, not the value of their assets, that causes financial stress. Also, there is no reason to believe that this approach would permenantly increase or stabilize land prices because the federal government would eventually sell the land.